No. 2868

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

A. M. SHOOK, Trustee of the Estate of FARMERS DAIRY ASSOCIATION, a corporation. Bankrupt.
Appellant.

vs.

A. LEVI,
Appellee.

Brief of Plaintiff, Appellant

A. L. WISSBURG,
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STATEMENT

This is an appeal from an Order and Judgment of the United States District Court for the Southern District of California, Hon. B. F. Bledsoe, Judge, reversing and setting aside an Order and Judgment of the Referee in Bankruptcy of the United States District Court for the Southern District of California, Southern Division, Hon. E. T. Lannon, Referee, which said Order and Judgment was made and entered by said Referee on the 27th day of September, A. D. 1915.

The facts disclosed by the record, briefly stated, are: That on the 28th day of July, A. D. 1915, an involuntary petition in bankruptcy was filed in the United States District Court for the Southern District of California, Southern Division, by certain creditors of the Farmers

Dairy Association, a corporation, alleging said corporation to be insolvent and unable to meet its obligations; that on the 18th day of August, A. D. 1915, said Farmers Dairy Association, a corporation, was duly adjudicated a bankrupt. That on the 7th day of September, A. D. 1915, A. M. Shook, Esq., Appellant herein, was duly appointed the Trustee of said bankrupt estate, and on said date qualified as such Trustee and has been since said date, and now is, the duly appointed, qualified and acting Trustee of said bankrupt estate.

That on the 12th day of September, A. D. 1915, the petitioner, A. Levi, Appellee herein, filed a petition in reclamation in said proceeding, which said petition is duly set forth in the record herein; that said petition in reclamation came on for hearing before Hon. E. T. Lannon, Referee, on the 23rd day of September, A. D. 1915, evidence being received therein, and on the 27th day of September, A. D. 1915, the Referee made an order and rendered a judgment denying the petition of said Levi, and dismissing same.

The facts disclosed by the record and the Referee's certificate on review to the United States District Court, briefly stated, are: That on the ....day of..... A. D. 1914, petitioner, A. Levi, sold to the bankrupt Corporation, two certain horses, and on the .... day of ....., A. D. 1914 petitioner sold said bankrupt Corporation two additional horses; and on the .... day of ....., A. D. 1914, petitioner sold said bankrupt Corporation five additional horses; that said sale of horses was made by petitioner to the bankrupt Corporation through its President, Mr. N. J. Peavey; that each of said sales were verbal, no written

instrument whatever passing between the parties, and, according to the evidence, it was *verbally* understood between petitioner and said Peavey that the title to said horses should remain in the vendor until the purchase price was paid; that on the 20th day of July, A. D. 1915, which was shortly after the incident above referred to, relating to the first purchase of horses, the matter of the purchase of the horses was brought to the attention of the board of directors of said Corporation, at its regular meeting. The minutes of said meeting, which were introduced in evidence by the Trustee, recite the following with reference to said first purchase of horses:

> "It was moved by L. A. Serrano, seconded by W. E. Stewart, and carried, that the matter of the purchase of two horses be purchased at $125.00 and $135.00 as follows: ½ due in six months, ¼ in nine months and the balance in one year."

That on the 16th day of August A. D. 1915, which was shortly after the incident above referred to, relating to the second purchase of horses, the matter of the purchase of the horses was brought to the attention of the board of directors of the bankrupt Corporation, at its regular meeting. The minutes of said meeting, which were introduced in evidence by the Trustee, recite the following with reference to the second purchase of horses:

> "It was moved by L. A. Serrano and seconded by W. E. Stewart that we purchase of Adolph Levi the two horses on the terms that the others were purchased."

That immediately after the passage of the above resolutions, the Corporation, through its proper officers, and

pursuant to said resolutions, executed its negotiable, promissory notes to petitioner, A. Levi, in payment for said horses; that, according to the evidence of petitioner, and Mr. Peavy, said notes represented the purchase price of said horses, and were received and accepted by said Levi in *payment* for said horses; that the notes did not reserve the title to the said horses in the vendor; that in the body of two of the notes, which were the last notes representing each transaction, were inserted by Mr. Edgar Levi, son of petitioner, the following words:

> "Balance in full for one Bay Mare and one Bay Horse known as the Enricca Mare and Horse", and "Balance in full for one Bay mare and one Bay horse."

That each and all of the notes so given in payment for said horses were in the possession of, and the property of, A. Levi, petitioner, at the time of the adjudication in bankruptcy of said Corporation.

That, according to the evidence, Mr. H. Stephenson, was Secretary of the Corporation at the time of the purchase of the last five horses; that notes, representing the purchase price for same were presented to him at the time of said purchase; that said notes were negotiable promissory notes, and he signed said notes as Secretary; that at the time said notes were presented to him for signature, and at no time since, was he informed that title to said horses was reserved in the vendor, nor were any conditions which may have been attached to the sale of said horses made known to him, but he understood that the notes so signed by him as Secretary were to be given by the Corporation, and accepted by the vendor, in payment of the purchase price for said horses.

The evidence further discloses the fact that the Corporation carried all of said horses on their books as an asset of the Corporation; that monthly statements of the business of the Corporation had been gotten out by the Corporation for the benefit and information of its creditors; that credit was extended to the Corporation on the strength of its financial statements; that said horses were carried in said financial statements as an asset of the Corporation; that the petitioner, A. Levi, had received such statements, and from said statements knew the condition of the Corporation, and knew that the Corporation were claiming said horses as an asset, and that petitioner, at no time prior to the bankrupt's adjudication, according to the evidence, asserted in any way, his right or title to said horses; that said Corporation kept said horses in charge from the time of their purchase up to the time of the adjudication and at all times exercised indicia of ownership over said horses; that said Corporation had made several payments on the notes so held by Levi, representing the purchase price of said horses, and said payments were endorsed as credits on said notes.

The books of the Corporation, and the monthly financial statements of the Corporation were offered in evidence by the Trustee, which showed that said horses were therein carried as an asset of the Corporation. Vouchers showing payment on the notes to A. Levi were also introduced in evidence.

From the above statement of facts, which is in accord with the Referee's Certificate on Review to the United States District Court, the Referee held that, so far as the Corporation itself and the creditors of the Corpora-

tion were concerned, the sale of said horses to the Corporation was absolute; that title to said horses vested in the Trustee for the benefit of the creditors of the bankrupt Corporation; that the contract between petitioner, A. Levi, Appellee herein, and Mr. Peavey, if such a contract existed, was not one of conditional sale as would bind the Corporation and its creditors, and the Referee, after considering the facts and the law denied the petition of Mr. Levi, and dismissed same.

On review of said proceedings by the United States District Court for the Southern District of California, Hon. B. F. Bledsoe, Judge, an opinion was rendered by said Court and filed on May 29th, 1916, determining the issues between the Trustee herein, and petitioner, A. Levi, upon a basis not contemplated by either of the parties connected with said proceedings, or their attorneys, and upon a theory foreign to and entirely without the scope of the evidence—Mr. Levi, according to his petition in Reclamation admitting there was a sale of the horses, but contending that such sale was a conditional one—the Trustee contending that from the facts and circumstances, and all the facts and circumstances, said sale of horses was absolute to the Corporation, and said property should be held by the Corporation and for the benefit of its creditors.

ARGUMENT.

A. THE COURT ERRED IN RENDERING A DECISION CONTRARY TO THE WEIGHT OF THE EVIDENCE.

The Appellant, herein, to sustain his assignment of error in this connection relies upon the Referee's Cer-

tificate on Review to the United States District Court, which is a part of the Record herein, and which contains a summary of the evidence, to which the attention of this Court is respectfully referred. Under no theory of the case, as was submitted by counsel representing the contesting parties, nor under the evidence itself, could the United States District Court hold that there was no contract of sale whatsoever, which seemed to have been the Court's reasoning herein, for however liberal the Court wished to be with petitioner, Appellee herein, it cannot disregard his own Petition in Reclamation, which is a part of the record herein, in which petitioner admits a sale of the horses in question to the Bankrupt Corporation, nor can the Court disregard the evidence taken at the hearing before the Referee in which there was no dispute as to a sale. The main question being, if, under all the facts and circumstances, said sale of horses was conditional, in which event the title to said horses would vest in the petitioner, Appellee herein, or absolute, in which event the title to said horses would vest in the Trustee, Appellant herein, and this, the District Court, in the rendition of its decision, failed to consider.

(a) *Burden of Proof.*

The authorities hold that in a proceeding of this kind, the burden of proof rests upon him who claims the sale to have been a conditional one rather than absolute. The burden of producing a preponderance of the evidence is upon the party who has the affirmative of the issue and remains with him throughout the trial.

Code of Civil Procedure of California, Sec. 1869;

Code of Civil Procedure of California, Sec. 1981;

Scott vs. *Wood,* 81 Cal., 398;
Petaluma P. Co. vs. *Singley,* 136 Cal., 618;
Osgood vs. *Los Angeles T. Co.,* 137 Cal., 283;
Estate of Latour, 140 Cal., 421;
Holmes vs. *Warren,* 145 Cal., 460.

From the evidence herein, the only proof shown by petitioner, Appellee, is a *verbal* understanding he had with one Mr. Peavey, the President of the Bankrupt Corporation, that the title to the horses was reserved in petitioner until the purchase price therefor was paid. There is no proof, nor is there any intimation or suggestion of proof that the Bankrupt Corporation itself, acting through its Board of Directors, had any knowledge whatever of any condition attached to the sale of said horses, but, as is shown from the resolutions adopted by the Board of Directors, which is a part of the evidence, the sale was absolute, the Corporation giving negotiable promissory notes in payment of the purchase price for said horses, which notes were accepted by the vendor for the purchase price of said horses, according to petitioner's own evidence.

There is evidence to the effect that the Corporation had gotten out monthly financial statements of its assets and liabilities; that such statements were sent to the creditors, and that petitioner had received such statements and knew that the horses were claimed by the Corporation as its property. The burden is also on petitioner to show that the creditors, who had parted with value to the bankrupt, had actual notice of the conditional sale when they did so. In *Re Basemore,* 26 A. B. R., 498.

Having access to the books of the Corporation and having received its monthly financial statements, and not having in any way asserted his right or title to the horses in question under such purported conditional sale contract, as is contended by the Appellee, and having allowed the Corporation to carry the horses on their books and in their statements as their property, petitioner is now estopped from claiming the horses under the purported conditional sale contract, for it is too late to assert his title, if any he had, only at a time when there is grave fear of his inability to receive face value of the notes given in payment of the horses.

Giberson vs. *Fink,* 28 Cal. App., 25;

Hughes vs. *McAlister,* 55 Am. Dec., 143.

Courts are unanimous in holding that the failure of a party to give notice of a right in property where another without knowledge and in good faith is investing money, that such party is precluded from subsequently setting up that right thus concealed.

Fletcher vs. *Holmes,* 25 Ind., 458;

Peters vs. *Canfield,* 42 N. W., 125.

(b) It being conceded there was a sale of said horses to the Corporation—the only question in dispute being as to whether or not such sale was a conditional or an absolute one, the court erred in deciding the case on a theory foreign to the facts and the law.

However liberal the Court wished to be with the petitioner, Appellee herein, it cannot estrange itself from all the facts and circumstances attending the sale, for under all the authorities, where the property rights of

innocent creditors are involved, such facts and circumstances must be considered.

In *Edwards* vs. *Symonds,* 65 Mich., 348-355, it is held that a rule of law that permits a vendor to retain the title to goods bartered by him and placed apparently in the exclusive possession, ownership and control of the vendee until the whole purchase price is paid, without notice to parties dealing with such vendee, is at best a harsh one and should not be enforced except in cases where the agreement to so hold the title is positive and unambiguous.

In *In Re Leeds Woolen Mills,* 12 A. B. R., 136, at page 148, Judge Hammond clearly lays down the rule as follows:

> "We know from judicial experience in the administration of the bankruptcy statute, and from the numerous cases arising in the bankruptcy courts everywhere, that there is a tendency on the part of sellers of merchandise to protect themselves against the possible bankruptcy of their customers by equivocal devices which would enable them to claim a sale if the customer goes through the pending difficulties safely, but to claim ownership if he fails and becomes bankrupt. Resort is had oftentimes to undeniable and effective conditional sales and retention of the title, with similar methods of dealing to that we have here and with reservations appropriate to that kind of security, but sometimes it is not convenient or desirable to take the effective way of retaining title or making conditional sales, and yet the desire is to give to the transaction that false appearance, so as to meet possible emergencies. Therefore in my judgment it is the duty of the bankruptcy court to scrutinize such transactions with the utmost care, and protect the assets of bankrupts against invasions that may come by dubious dealings in business; and I think the rule

of law is established that the seller must show the utmost good faith in the transaction, and the burden is upon him to establish the fact by a preponderance of the testimony that he remains an owner and did not become a seller and creditor. The court cannot allow him to shift his position from creditor to owner upon any except the clearest proof of such self protection, made in good faith at the inception of the dealing, and not conceived afterwards for the purpose of escaping from a bad bargain."

Mushowaka Woolen Mfg. Co. vs. *Westveer,* 27 A. B. R., 345;

Matter of Penney and Anderson, 23 A. B. R., 115;

In Re Harriett E. Wells, 15 A. B. R., 419;

In Re George O. Hassam and Son, 18 A. B. R., 745;

Pontiac Buggy Co. vs. *Skinner,* 20 A. B. R., 206.

In *Mushowaka Woolen Mills* vs. *Westveer, supra,* reading from the syllabus:

"In determining whether a contract contemplates a conditional or an absolute sale of goods, the fact alone that the title to the goods is, in terms, reserved in the vendor until payment is made, does not necessarily import a conditional sale, but the court will take into consideration the whole instrument, as well as the acts and circumstances attending its execution and performance."

In *In Re Geo. O. Hassam, supra,* at page 749, the Court says:

"In the case at bar there is an attempted lien, absolutely secret, not even made known to the vendee, and never intended to be brought to light unless the vendee should become insolvent. The vendee was put in possession of a large number of wagons of which he was apparently the absolute

> owner. There was a secret attempt on the part of the vendor, should the vendee succeed in getting credit by having about him a large amount of unencumbered property and should thereafter be unable to pay debts so incurred, to make time notes given for said property 'immediately due and payable', and the vendee delivering to the vendor all goods remaining unsold, and all the while they should remain in the vendor. I cannot conceive in what manner the vendor anticipated that the goods could remain in its name when possession was passed to the vendee and no record made of the transaction. It has been repeatedly held that when personal property is delivered to a vendee for sale, or to be dealt with in a way inconsistent with the ownership of the seller, or so as to destroy his lien or right of property, the transaction cannot be upheld as a conditional sale and is fraud upon the creditors of the vendee." Citing *In Re Gracewich,* 8 A. B. R., 149; *In Re Carpenter,* 11 A. B. R., 147, 125 Fed., 831; *In Re Howland,* 6 A. B. R., 495,109 Fed., 869; *In Re Rogers,* 11 A. B. R., 93, 125 Fed., 169; *In Re Butterwick,* 12 A. B. R., 536, 131 Fed., 371.

In what position then, does the petitioner, Appellee herein, stand in this matter. According to his own contention, the only proof of a conditional sale of the horses to the bankrupt corporation, was a *verbal* understanding he had with one Mr. Peavey, the President of the Corporation, concerning a reservation of title. The Corporation, to his knowledge, were buying the horses outright, and he accepted the notes of the Corporation in *payment of the purchase price.* The Corporation was carrying the horses on its books as its property, and were so informing its creditors by its monthly financial statements, which statements petitioner had also received and took cognizance of; the Corporation exer-

cising indicia of ownership over the horses at all times since the sale by petitioner, petitioner cannot, after an adjudication in bankruptcy of the Corporation, hold up his hands in "holy horror" and remembering some private and secret understanding he had with the President of the Corporation, deprive the creditors of their just share in the distribution of the assets.

(c) The Corporation, through its Board of Directors acted in good faith in the purchase of the horses, and according to the resolutions adopted, and all the facts and circumstances attending the sale, purchased the horses outright.

A Corporation can only act by and through its Board of Directors in the making of contracts.

Cook on Corporations, 7th Ed. Secs. 712, 714, 716;

Gashwiler, et al. vs. *Willis, et al.,* 33 Cal., 11;

Pauley vs. *Pauley,* 107 Cal., 8;

Barney vs. *Pforr,* 117 Cal., 56;

Fontana vs. *Pac. Com. Co.,* 129 Cal., 51.

The board of directors to whom the authority to bind a corporation is committed is not the individual directors scattered here and there, whose assent to a given act may be collected by a diligent canvasser, but it is the board sitting and consulting together as a body. Individual directors, or any number of them less than a quorum, have no authority as directors to bind the corporation. And this is equally the rule although the director who assumes to do so may own a majority of the shares.

10 Cyc., 775;

Bank vs. *Bailhache,* 65 Cal., 327;

Monroe Mercantile Co. vs. *Arnold,* 34 S. E., 176;

Morrison vs. *Wilden Gas Co.,* 64 Am. St. Rep., 257;

Lockwood vs. *Thunder Bay Boon Co.,* 4 N. W., 292;

Nicholson City Co. vs. *Smalley,* 51 S. W., 527;

Limer vs. *Traders Co.,* 28 S. E., 730;

Ney vs. *Eastern Iowa Tel. Co.,* 144 N. W., 383;

State Savings Bank vs. *Winchester,* 25 Cal. App., 694.

According to the evidence, the board of directors of the bankrupt Corporation contracted with petitioner for the purchase of the horses and to pay for them in six, nine and twelve months, giving the negotiable promissory notes of the Corporation in payment of the purchase price. Mr. Levi accepted the notes in payment of the purchase price, *according to his own evidence.*

No mention was made of a condition attached to the sale of the horses at the time to the board of directors, or at any time to anybody, until after the Corporation's adjudication in bankruptcy. If there was a conditional contract entered into between petitioner and Mr. Peavey, the president of the Corporation, reserving the title to the horses, such a contract was kept in the strictest secrecy from the board of directors and the creditors of the corporation, was made between Mr. Levi and Mr. Peavey, who had no authority whatsoever to bind the Corporation in that way, and to whom Mr. Levi must look individually for the fulfillment of that particular phase of it.

Ney vs. *Eastern Iowa Tele. Co., supra;*

Clark and Marshall on Priv. Corp., Vol. 3, Sec. 728;

Groeltz vs. *Armstrong R. E. Co.,* 89 N. W., 21.

(d) The facts further disclose that the Corporation gave Mr. Levi its negotiable promissory notes in payment of the purchase price of said horses, which notes were accepted by Mr. Levi in *payment of the purchase price of said horses according to his own evidence.* The notes were so endorsed. Can there be any question, from the acts and circumstances surrounding the giving and acceptance of the notes, and from the endorsements on the notes, that such was the express agreement between the parties?

Where there is an express agreement to accept notes in payment, the original debt is extinguished;

30 Cyc., 1199;

78 Cal., 20;

122 Cal., 33.

and where it is agreed and understood that the notes given shall operate as payment, the creditor cannot sue on the claim but is confined to his remedy on the notes.

Carter, Rice Co. vs. *Howard*, 39 N. Y. Sup., 1060;

Carriere vs. *Ticknor*, 26 Ala., 561.

The presumption is in favor of the notes being accepted in payment and satisfaction of petitioner's demands, and the burden of proof is upon him to meet this presumption. The intent is gathered from the acts and circumstances.

Hall vs. *Stevens,* 116 N. Y., 201;

Whitbeck vs. *Van Ness,* 6 Am. Dec., 383;

Gibson vs. *Tobey,* 46 N. Y., 637.

We respectfully submit to the Court the examination of the whole record in this cause, firmly believing that

it will find prejudicial error in the ruling of the District Court, warranting a reversal of such judgment and ruling, and an affirming of the ruling and judgment of the Referee in Bankruptcy.

Dated San Diego, California, January 18, 1917.

A. L. WISSBURG,
Attorney for Appellant.